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BUSINESS AND PROFESSIONAL TAXES AS SOURCES OF LOCAL REVENUE¹

In 1902 upward of 82 per cent. of the tax revenues of our state and local governments were drawn from the general-property tax. And 7.24 per cent. were drawn from special-property and business taxes, a part of which are closely related to the general-property tax.

This situation is not satisfactory. In the first place, the rates imposed have increased until they have become burdensome. This is due largely to the concentration of population in cities, giving rise to rapidly increasing expenditures resting upon taxation. In many of our cities, the combined rates for state, county, and municipal purposes would exceed $1\frac{1}{2}$ per cent. on a full valuation of the property assessed.

In the second place, partly as a result of these high rates, the general-property tax has broken down in its administration. Evasion and under-valuation are very generally practiced where possible. Many have, therefore, concluded that it is better to change the law and to get at taxable ability otherwise than through the most inclusive property tax. There is a demand that at least certain forms of personal property be relieved from ad valorem taxation.

In the third place, there is at the same time, a demand that direct taxation shall be extended. Property holdings now taxed are not sufficiently indicative of ability to contribute to the support of government. There are many professions and trades yielding large returns to those who follow them, scarcely touched by property taxes. In some lines of business little tangible property is used, while where there is considerable property used, it must be admitted that as between different kinds of business there is no relation between the amount of such property and the amount of profit reaped. Hence to reach all ability directly

¹ Read at the National Conference on State and Local Taxation, held at Columbus, Ohio, November 12-15, 1907, under the auspices of the National Tax Association.

and equitably it is necessary to employ more than mere property taxes uniformly levied.

Of the measures to equalize taxation and to keep down the general-property tax rates the income tax is most frequently urged. Such a tax has been widely employed in this country as a source of state revenue and not infrequently of local revenue as well. What has our experience with income taxation been?

We have used both "faculty taxes" and "income taxes" in the narrower sense of the term.

"Faculty taxes" were employed at some time or other in all save two—Georgia and North Carolina—of the thirteen states in existence at the time of the formation of the Constitution and, for a time, in the Northwest Territory. These were supplementary to taxes on property and polls—where the latter were levied. The incomes of professional men, of skilled mechanics, occasionally of less skilled workmen, sometimes those from the dealing trades, and occasionally those from toll-bridges, ferries, and the like, were listed and taxed along with property. Property was, as a rule, assessed according to its annual value, or else listed and taxed at rates, specified in the law, based upon that value. To reach income from various sources directly seems to have been the working ideal.

But because of poor administration and the narrow application of the law, "faculty" counted for little in the returns. In most instances it was dropped from the taxable list before the close of the eighteenth century, and in the other states, save Massachusetts, it disappeared with the adoption of the general property tax in its modern form.

Though there is a question as to what constitutes an "income tax," if we follow Professor Kinsman's account,² income taxes, properly speaking, have been employed in sixteen of the commonwealths. They are still employed in four states—Massachusetts, Virginia, North Carolina, and South Carolina.

The sixteen embrace Massachusetts, Pennsylvania, Delaware, and all of the southern states save Arkansas and Mississippi.

² Kinsman, *The Income Tax in the Commonwealths of the United States*, Publications of American Economic Association; third series, Vol. IV.

The income tax has also been employed as a source of local revenue as in Louisiana and Georgia.

In Massachusetts the income tax developed from the faculty tax already mentioned. In six states it was adopted during the 1840's when the treasuries were in straitened circumstances because of unremunerative improvement and banking enterprises undertaken. In five more it had its origin in the Civil War. In at least two of the other four states the income taxes were introduced under somewhat similar circumstances. It was necessary to find new sources of revenue in order to keep the general-property tax rates within due limits.

But while largely the invention of necessity, these taxes have usually been supplementary to the property taxes used. In Virginia, North Carolina, Alabama, and South Carolina alone have they for any considerable period, been sufficiently inclusive to be called general income taxes, and in North Carolina since 1868 incomes from property taxed have not been assessable under the income tax law. Like the "faculty taxes" they have generally been devised to reach special sources of income not otherwise reached.

From the point of view of revenue produced the income taxes have been of little importance and, where retained, have become almost a farce. This small yield is partly explained by the special character of the taxes imposed. It is partly explained by careless administration or failure to enforce the law. And this failure to enforce the law has been due, to an extent, to the fact that the taxes have frequently been regarded as class taxes, but more to the fact that their administration has been incidental to the work of local officials, while the revenue was to be paid over to the state treasuries. And, finally, where an honest effort has been made to enforce the law the opportunities for evasion have proven too difficult to overcome.

The state income taxes have been little better than failures in practice, and slight improvement can be expected so long as we rely upon the personal declarations of taxpayers in making assessments. Our experience with federal and state income taxes lends no hope that under ordinary circumstances can an income

tax be made satisfactory except by getting at the greater part of incomes before they come into the hands of the individuals who bear the tax burden. But unfortunately, in state and local income assessment, especially if the taxes are supplementary to property and corporation taxes, this cannot be done to any great extent.

But is there not an alternative? Can we not make use of business and occupation taxes so levied as to reach income with a fair degree of justice and thus supplement property taxes so as to prevent these from becoming unduly burdensome, so as to make it more feasible to give up the taxation of property where it proves difficult, and so as to reach directly ability not directly and adequately reached by such property taxes as can be employed with a fair degree of success? We have had an extensive experience with such taxes, usually denominated "business license," "privilege," or "occupation taxes." What has this experience been and what does it teach?

The history of these business taxes cannot be given here. Suffice it to say that in several instances those levied primarily for revenue have long been used. In the majority of instances, extensive systems of business and professional license taxes for revenue as opposed to regulative purposes, were introduced, like the income taxes, when the treasuries were depleted during the 1840's, 1850's, and the Civil War period. Frequently they and the income taxes were complementary. Extensive use by cities usually accompanied or preceded such use by the states.

Once introduced they have usually been retained. In California, it is true, they were abolished for state purposes some thirty-five years ago, and have since been systematically employed by only a part of the cities. In Texas in so far as they rested on "useful occupations," they were abolished by the last general assembly (1907) and are no longer to be employed by the state, county, and municipal authorities. In a few instances the systems have been materially contracted. But in most of the southern states—where they are chiefly employed—if due allowance is made for readjustments after the close of the Civil War, they have not only held their own but have been imposed upon

additional occupations and at generally increasing rates, for both state and local purposes.

At present nearly all of the commonwealths levy license taxes on dealers in liquors, peddlers, and traveling vendors, and various kinds of amusements, primarily for the purpose of regulation or suppression. Those imposed upon the liquor traffic are usually very productive. Again, in most of the states taxes are levied on the business of insurance companies and in not a few instances the taxes on railroads, express, telegraph, telephone, and car companies take the form of a levy upon their gross earnings, either in lieu of or in addition to taxes on their property. But with these we shall not deal. The discussion will be limited to those taxes falling upon many occupations and trades and levied primarily for the purpose of revenue. Such are now rather extensively employed in about one-third of the states, the object being to keep the general-property tax rates down, to replace or to supplement property taxes, and to reach income not reached through such property taxes as are employed.

These taxes are more or less systematically employed for state purposes in Pennsylvania, Delaware, West Virginia, in all of the southern states save South Carolina, Missouri, Arkansas, and Texas, and also in New Mexico, Idaho, and Montana. In practically all of these states and in several others similar taxes are employed—and frequently much more extensively—for municipal purposes. In some cases (as in North Carolina, Florida, Alabama, and Louisiana) the county governments are permitted to use—with minor exceptions—the business taxes employed by the state, but in other cases (as in Virginia, Georgia, and Kentucky) they may not be so employed, the county governments being practically limited to the general-property tax.

The legislation bearing upon these taxes comprises a great mass of details not capable of accurate generalization. There is little which may be regarded as typical. At the one extreme we find a few occupations and trades taxed for revenue purposes; at the other, practically all trades and businesses carried on in cities. In Louisiana we find the most inclusive system for state

purposes. There the constitution of 1898 (Article 229) authorizes the general assembly to levy license taxes upon

all persons, associations of persons and corporations pursuing any trade, profession and calling, except clerks, laborers, clergymen, school teachers, those engaged in mechanical, agricultural, horticultural, and mining pursuits, and manufacturers other than those of distilled, alcoholic, or malt liquors, tobacco, cigars, and cotton-seed oil.

The state makes full use of the power thus given and authorizes the municipalities and parishes to levy upon the same subjects, provided that with the exception of the liquor licenses, the state rates shall not be exceeded. In many of the cities in other states systems still more inclusive are found. Wilmington, North Carolina, for example, some years ago levied license taxes upon one hundred and twenty-four classes of business. The license-tax ordinance now in effect in Atlanta contains 466 items; thus permitting few persons other than manual laborers to follow their callings untaxed.

The exemption of most branches of manufactures from license taxation is, however, very general in the South, and where this exemption does not obtain the business tax is almost nominal and is added to a property tax.

The mercantile trades, on the other hand, are very generally taxed—not only those with little stock in trade but also those with regular stocks of goods and fixed places of business. In a few instances, as in Pennsylvania and Virginia the license taxes are in lieu of taxes on the stocks of goods carried, but this substitution is rather exceptional. More frequently they are a second contribution exacted, being imposed because of fiscal necessity or because of the feeling that such property would otherwise not bear a fair share of the tax burden.

The professions are very generally, though by no means universally, taxed as a part of the license-tax systems employed.

The revenue from the business-tax systems now employed varies greatly of course with the number of subjects embraced.

In Louisiana licenses other than for the liquor traffic in 1902 produced 12.49 per cent., in Virginia 13.03 per cent., as much revenue as the property taxes levied for state and local purposes.

The corresponding percentages for several of the more important southern cities, for the year 1905,³ are as follows: New Orleans, 6.8; Richmond, 8.0; Norfolk, 25.7; Nashville, 14.7; Atlanta, 15.5; Augusta, 19.7; Savannah, 20.4; Mobile, 34.7; Birmingham, 47.2; Charleston, South Carolina, 20.0.

Turning from fiscal results let us briefly note some of the shortcomings of the system as found especially in the southern states.

In the first place, there has been much complaint of evasion. In spite of the license required, that practiced by the members of the liberal professions has been very flagrant. Again it is a rather common occurrence, especially in trade, to make one license serve where two or more are required for the businesses combined. But evasion of this kind is not inherent in the business-license tax system; it is due to inefficient administration. If the taxes were heavy enough to make collection worth the while, inspectors might be appointed, as they have been for some years in Atlanta, and the law fairly well enforced. However, most of the evasion has taken another form to be indicated a little later in the discussion.

Again, the complaint is frequently met with that these taxes are inconvenient and that they repress and fetter industry. That they are inconvenient, especially in the small trades where frequent changes are made requiring repayment or transfer of the license, is true. That they do repress industry must be admitted, but that is characteristic of most taxes. If the system were arranged so as to be just and stable, the business-license system would not be particularly objectionable on this score. Of vastly more importance is the fact that the system involves special legislation, is necessarily arbitrary, is made reasonably just only with difficulty, and has everywhere been subject to almost constant change with consequent uncertainty and loss of efficiency in administration.

The license-tax systems as they exist in the southern states and cities are the result of almost constant tinkering on the part

³ Based upon *Statistics of Cities Having a Population of Over 30,000* (1905), Bureau of the Census, Washington, 1907.

of the legislative bodies. There and elsewhere the frequency of amendment is the thing most striking to the investigator. This fact is due to the many problems which have arisen in connection with such taxation.

Where the system has not been very inclusive, struggles have been frequent over what things should be embraced within it. In nearly all of the southern states and cities there has been a fairly constant struggle between the owners of real estate and those interested in licensed business over the relative amounts of their contributions. The problem of what is a fair division of the burden between property and business has not been and perhaps cannot be satisfactorily and definitely settled.

Again, there has been much legislation designed to make rates fair as between taxable trades, with incidental struggles and shifting of burdens. To illustrate: in Louisiana, since 1880, those who follow most trades have been divided into classes based on gross receipts or sales and charged with specific sums according to class. The approximate percentage of receipts taken during this period has remained fixed for retail merchants alone. In 1882 the rates on wholesale merchants were doubled. In 1880 manufacturers (in so far as they were taxed in this manner) were taxed at about $\frac{7}{10}$ of 1 per cent. of their gross receipts; in 1902 those not specifically provided for, at $\frac{1}{40}$ of 1 per cent. But the rate on the receipts of refiners of sugar has been changed to $\frac{1}{8}$ of 1 per cent.; on saw-mill operators, distillers, brewers, and certain other manufacturers to $\frac{1}{4}$ of 1 per cent. In 1880 professional men were taxed at about $\frac{1}{2}$ of 1 per cent. of their gross incomes; in 1902, at from $\frac{3}{10}$ of 1 to 1 per cent., the taxes being generally regressive. Thus had the burden been redistributed among these classes. Elsewhere changes of the same kind have been of frequent occurrence.

Another problem more difficult, and not as yet solved by our states and cities, relates to the graduation of rates so as to be fair among those following a given trade or profession. In the southern states, except Louisiana, most of the taxes are uniform upon all the members of the given trade. But where there is much difference in the amount of business done the uniform

impositions become very unfair and, if large enough to yield a revenue worth the while, become a distinct evil.

This was the situation in Louisiana prior to 1880 when the essentials of the present methods of graduation were introduced. Under the tax law of 1879, the state in order to get an adequate revenue imposed very heavy license taxes and almost all without graduation. To these, local impositions, frequently much heavier, were added. The burden fell upon those whose net earnings were least and the injustice of the system gave rise to a struggle in the constitutional convention of 1879 to eliminate all privilege taxes save those required for regulative purposes. However, the use of purely revenue privilege taxes was retained, the provisos being made that the local governments should not impose amounts in excess of the state rate upon any subject save the liquor traffic, and that all such taxes, whether used for state or for local purposes, should be graduated.

Since the adoption of the constitution of 1879, hotels, boarding-houses, and lodging-houses have been taxed roughly according to the number of rentable rooms. This is a definite and not particularly unjust graduation of the payments required. Theater buildings and the like have been taxed according to seating capacity—an equally satisfactory arrangement. Such branches of manufactures as were formerly licensed in New Orleans were taxed according to the number of employees, and this principle of graduation has been applied elsewhere. It is definite, easily applied, and comparatively fair. But some other method must be found for graduating the exactions made of professional men, wholesale and retail dealers, and of financial institutions. In those cases great difficulty has been met with in finding a principle of graduation which can be applied easily and successfully, and which is at the same time equitable.

In Louisiana the graduation in the vast majority of trades and the professions has been on the basis of gross earnings, and this, or the related one of purchases, has usually been applied elsewhere to the mercantile trades when uniform taxes were departed from. It has, of course, been frequently applied to corporations and with great administrative success. But because of the absence of safeguards, in the taxation of merchants and

other trades, it has been accompanied invariably by a vast amount of evasion and dishonesty. In Texas merchants generally rated themselves in the lowest of the eleven classes; in Pennsylvania and Virginia, where merchants' stocks are exempted from taxation, there has been much dereliction of duty on the part of the officials charged with the enforcement of the law or else much perjury practiced by the merchants. And in Louisiana the same evil is widespread. A few years ago of the 1,603 saloons licensed in New Orleans, there were only 19 which reported gross receipts in excess of \$5,000 per year, and many of those reporting less than \$5,000 were known to spend more than that amount for wages and rent. In other lines of business there is less dishonesty and perjury, but much is admitted to exist. In spite of the fact that the authorities may question returns made and have books and accounts and other evidence produced in the courts, and in spite of heavy penalties for false returns, the system is rotten throughout. Unless there is to be much publicity and inspection of books and accounts—and these are objectionable and not very effective—the business tax thus graded is little better than the self-assessed income tax. It were better to tax professional men uniformly. In the taxation of merchants it is doubtful if it is any improvement over taxation of their stocks.

But is there no basis for graduation which will prove more acceptable? Is there no basis which will be perfectly definite, easily measured, will render evasion difficult or impossible, and which will at the same time be reasonably just?

There is. In 1904 the legislative body of the Province of Ontario in an Act Respecting Municipal Taxation adopted the assessed value of the real estate occupied in business and in the professions as the basis for their "business assessment" and taxation. (See *Statutes of Ontario*, 1904, chap. xxiii, sec. 10; *ibid.*, 1906, chap. xxxvi.) Under this law almost every trade, business, and profession conducted in a municipality is made taxable for municipal purposes on some percentage of the value of real estate occupied at the rate imposed on taxable real estate and incomes. The percentages of the assessed values of real estate occupied taken for the "business assessment" vary from 25 in several trades to 150 in the case of distillers.

Only incomes from sources other than property and businesses taxed are taxable under the income tax law. Personal property is exempt.

The base for the imposition of the tax is definite and its amount is easily ascertained. No inquisitorial methods need be employed; there is little opportunity for evasion and dishonesty. It may be applied to all professions, trades, and business with a definite location. If it is applied, one assessment will suffice in most cases for real estate and business taxes, thus simplifying and reducing the expense of administration.

But is it fair as between those engaged in a given business or profession—say retail trade? It must be admitted that the value of real estate occupied is not an accurate index of net receipts from the business done. It is not so accurate as gross earnings, if these can be ascertained accurately. But in practice in such a country as ours, with our habits of tax evasion and our dislike for inquisitorial methods, it is far preferable to taxation according to gross earnings except in the case of public-service corporations. The Ontario system promises to be vastly superior to any system of business-license taxes we have had in the United States. It is not ideal by any means. It is not equitable as between taxpayers of a given trade. Necessarily it involves special legislation, and the selection of percentages for the several trades is, and must be, more or less arbitrary. But it is not grossly unfair and any system of taxation must be more or less arbitrary. Moreover, it eliminates most opportunities for evasion and dishonesty and at the same time is simple and inexpensive in administration.

The business-license tax systems in the southern states are firmly established. Though many would advocate their abolition and heavier taxation of property or the substitution of an income tax (for state purposes), it is noteworthy that not one of the half dozen special tax commissions in the commonwealths employing those taxes has recommended such action. These tax commissions have recommended their retention and have found support in public opinion, in spite of their arbitrariness, constant change, injustice, and evasion, because of the relief they have afforded through the lower property tax rates, and because they are believed to reach ability not adequately reached in other ways.

Were some such system as that of Ontario substituted for those now employed, it is altogether probable that business taxation would find greater favor than it has in the past.

One point remains to be discussed, viz., the incidence of business and professional taxes.

It is generally assumed by tax commissions and public officials that these taxes are shifted by the taxpayer to the consumer of his product or services. But that this is not always true is certain. The taxes on the professions are usually so small that they do not affect the customary charges for services performed and therefore are not shifted. The same thing is true of many other subjects in the business-tax list. When imposed upon manufacturers, the incidence is in doubt. The shifting will depend among other things on the generality of the tax with reference to the market supplied, its amount, the prospect of its continuance, and the form it takes. Taxes imposed on wholesale and retail dealers will ordinarily be shifted to the consumers, though this may not take place to the full extent of the sums imposed.

Or, to put the matter in a different way, the incidence of these taxes is uncertain. This uncertainty is one objectionable feature of the system. Taxes seemingly equal may impose upon taxpayers very different burdens. Hence if the system is employed, the rates imposed must be fixed with reference to the possibilities of the burdens being shifted in varying degree.

These are the more important considerations connected with business and professional taxes. They may be used as a substitute for taxes upon certain forms of personal property which do not work well in practice; they may be used as a substitute for the income tax which is impracticable as a source of state and local revenue, as a means of reaching income not directly reached through property taxes; they may be used to keep down the property-tax rates. Nevertheless, it must be recognized that there are difficulties inherent in the system. It is more or less arbitrary and unjust, and this injustice may be increased by the uncertainties of shifting. If it is to be employed, the levy must be based upon a tangible fact, and this is found in the Ontario system.

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